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SUBJECT: UKRAINE: EU SEEKS MORE EFFORT ON GAS REFORM

Classified By: EEST Chief Louis L. Bono for reasons 1.4(b) and (d).

¶1. (C) Summary and Introduction: RELEX Acting Ukraine Director David Geer briefed econoff on the Commission's efforts to promote gas and public finance sector reform in Ukraine. Geer said that while Ukraine has made some progress, it has far to go. Commission officials believe the IMF bailout package is necessary to see Ukraine through the election, but unless "substantial progress" is made on gas and finance reforms in the next few weeks, Ukraine may lose out on World Bank and European Bank for Reconstruction and Development (EBRD) packages. Geer said the Commission remains concerned about Ukraine's sovereignty, of which, the gas transit system is a big component, but he concluded we must maintain a &clear head about our approach.⁸ End Summary.

¶2. (U) On October 2 a Commission delegation, led by RELEX Deputy Director General Hugues Mingarelli, met with Ukraine Vice Prime Minister Hryhoriy Nemryia to discuss Ukraine's efforts to implement a series of short and mid-term reforms in the gas and public finance sectors. The reforms were agreed to by Ukraine's Prime Minister Yulia Tymoshenko on July 27, 2009. Also present were representatives from the Swedish presidency, the IMF, World Bank, European Investment Bank, and EBRD.

¶3. (C) During the meeting, Nemryia claimed progress was being made on a number of reforms: Ukraine had agreed to join the Energy Community Treaty and the Extractive Industries Transparency Initiative (EITI), opened Naftohaz' books, drafted a new gas law in accordance with EU regulations, and improved gas collection efforts among industrial consumers, but not households. Geer questioned the sincerity of Tymoshenko's attempt to raise gas prices. The increase was overturned in court last month after a challenge by trade unions, and the Commission does not expect any further action before January presidential elections. (Note: As with the condition to raise gas tariffs, Tymoshenko stands to lose votes if she were to seek gas payments from household consumers. Nonetheless, Geer added that she probably stands to lose campaign contributions by collecting from industrial consumers. End Note.)

¶4. (C) According to Geer, Ukraine must make "substantial progress" on the short term reforms in the next few weeks, otherwise World Bank and EBRD funds will be withheld. While the Commission and IFIs seek progress on all of the reforms, Geer noted "the public finance reforms have a wider application." In this context, "the procurement law will serve as a litmus test." Tymoshenko submitted a procurement law to the parliament, but Geer said this draft fell short of EU standards. An adequate draft is with the cabinet, and Geer said Ukraine must take steps to enact it. Commission officials appreciate that the legislative process) new gas and procurement legislation) takes time, but Geer pointed

out that the GoU was "able to pass an election law in a snap." Mingarelli is scheduled to meet with Ukraine officials in early November to assess progress.

¶ 15. (C) Independently, an IMF team is in Ukraine completing its review before determining whether to disburse the fourth tranche of the \$16.4 billion bailout package. Geer said if the IMF review goes off track, this would be a problem, but the IMF understands the need to get the GoU through the election. He said the Commission is also considering a macro-finance package for 2010 in excess of 500 million euros if progress is made on the reforms.

¶ 16. (C) In a separate meeting with econoff, an advisor to Solana said the IMF tranche needs to go through, but we must continue to "hold Ukraine's feet to the fire." He said Solana will seek to have a "sit-down" with the new president after the election. He agreed that the U.S. and EU must continue to coordinate efforts and messages, but he said a trilateral approach at this point would upset some member states and provide unnecessary grist to Russia.

¶ 17. (SBU) For the list of the reforms, contact Louis Bono at BonoLL@state.gov.

Murray

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